FILE COPY

Office - Supreme Court, U. S.
FILED
OCT. 9 1942
CHARLES ELMORE CROPLEY
CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1942.

No. 24

MARINE HARBOR PROPERTIES, INC.,
Petitioner,

against

MANUFACTURERS TRUST COMPANY (successor by merger to The Mortgage Corporation of New York), as trustee for the benefit of certificate holders in mortgage guaranteed by Bond and Mortgage Guarantee Company, Guarantee #181,568,
Respondent,

MAURICE RUBINGER, trustee of Marine Harbor Properties, Inc.,

SAMUEL SILVERMAN, additional trustee of Marine Harbor Properties, Inc.,

MORTIMER RUBENSTEIN, foreclosure-receiver,

and

SECURITIES AND EXCHANGE COMMISSION

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF OF RESPONDENT MANUFACTURERS TRUST COMPANY AS TRUSTEE

CHARLES E. HUGHES, JR.,
CURTISS E. FRANK,
Counsel for Respondent Manufacturers Trust Company, As Trustee.

INDEX

PAGE

OPINIONS BELOW 1

JURISDICTION 2

STATUTES INVOLVED 2

STATEMENT OF THE CASE 3

QUESTION PRESENTED 6

ARGUMENT 7

FIRST: The dismissal of the petition was correct, because prior proceedings are pending in which it appears that the interests of creditors and stockholders would be best subserved 11

A. The proceedings pending in the New York State Supreme Court are "prior proceedings" within the meaning of Section 146, subdivision (4) 12

B. The pending proceedings in the State Court will best subserve the interests of creditors.. 15

SECOND: The dismissal of the petition was correct because it is unreasonable to expect that a plan of reorganization can be effected..... 35

CONCLUSION 48

CITATIONS

CASES: PAGE

Brooklyn Trust Co. v. *Rembaugh*, 110 F. (2d) 838 ..... 7, 13, 33, 35
Bryan v. *Speakman*, 53 F. (2d) 463, cert. den. 285 U. S. 539 26
Case v. *Los Angeles Lumber Products Co.*, 308 U. S. 106 ..... 11, 36
Chapman Bros. Co. v. *Security-First National Bank*, 111 F. (2d) 86, cert. den. 311 U. S. 652 .. 38
Chase Nat. Bank v. *10 E. 40th St. Corp.*, 238 App. Div. 370 21
Clinton Trust Co. v. *142-144 Joralemon Street Corp.*, 237 App. Div. 789 21
Consolidated Rock Products Co. v. *DuBois*, 312 U. S. 510 11
Crane, Metro Estates, Inc., et al. v. *Brooklyn Trust Co.*, 262 App. Div. 969 14
Depen v. *Lawyers' Title & Guaranty Company*, 72 F. (2d) 705, cert. den. 293 U. S. 619 32
E. T. C. Corp. v. *Title Guar. & Trust Co.*, 271 N. Y. 124 41
Feinstein, et al: v. *The Mortgage Corporation of New York*, 264 App. Div. 783 14
First Nat. Bank v. *Conway Road Estates Co.*, 94 F. (2d) 736, cert. den. 304 U. S. 578 ..... 14, 40
First Nat. Bank v. *Flershem*, 290 U. S. 504 8
Gordon v. *Ominsky*, 294 U. S. 186 10
Harkin v. *Brundage*, 276 U. S. 36 13
Hickey v. *Ritz-Carlton Restaurant & Hotel Co.*, 96 F. (2d) 748 10

PAGE

Highland Towers Co. v. *Bondholders' P. Committee*, 115 F. (2d) 58 37

In re Avrum Realty Co. (S. D. N. Y. #61,228) 33
In re Bailey Realty Co. (S. D. N. Y. #61,831) 33
In re Bedford Realty Co., Inc. (S. D. N. Y. #60,420) 33
In re Blinrig Realty Corporation, 114 F. (2d) 100 ..... 8, 13, 33, 35, 46
In re Castle Beach Apartments, 113 F. (2d) 762; (S. D. N. Y. #75,836) 29, 35, 46
In re Central Funding Corporation, 75 F. (2d) 256 36
In re Church E. Gates & Co., 97 F. (2d) 911 34
In re City Bond and Mortgage Corp., CCH Bankruptcy Law Service, ¶ 8118.01; Dec. ¶ 4512 40
In re Clarose Holding Corp. (E. D. N. Y. #27,674) 33
In re Coney Island Hotel Corporation, 76 F. (2d) 126 ..... 33, 34
In re Cook, 104 F. (2d) 981 ..... 7, 10, 13
In re Corn Kelly Corporation, 32 F. Supp. 572, aff'd 111 F. (2d) 644 ..... 14, 38
In re Coronado Hotel Co., CCH Bankruptcy Law Service, ¶ 8116.03; Dec. ¶ 3002 40
In re Day & Meyer, Murray & Young, 93 F. (2d) 657 38
In re Duce Realty Corp. (E. D. N. Y. #27,928) .. 33
In re Dutch Woodcraft Shops, 14 F. Supp. 467 ... 35
In re Francfair, Inc., 13 F. Supp. 513 .... 7, 8, 14, 33, 34
In re Frank Realty Co., 31 F. Supp. 816 28
In re Grigsby-Grunow Co., 77 F. (2d) 200 10
In re Heilbroner, 69 F. (2d) 643 25-26
In re Hotel Park Central, Inc., CCH Bankruptcy Law Service, ¶ 8116.03; Dec. ¶ 3545 40
In re Island Park Associates, 77 F. (2d) 334 34
In re Julius Roehrs Co., 115 F. (2d) 723 7
In re Mallalieu & Conrey, Inc., 10 F. Supp. 808 13
In re Manbeach Realty Corporation, 10 F. Supp. 523 34

PAGE

In re Murel Holding Corporation, 75 F. (2d) 941 ..... 14, 46
In re North Kenmore Bldg. Corp., 81 F. (2d) 656 ..... 7, 8, 40
In re Paloma Estates, 126 F. (2d) 72, cert. filed May 12, 1942, No. 89 this term 13, 31, 33, 35
In re Philadelphia Rapid Transit Co., 8 F. Supp. 51, aff'd 73 F. (2d) 1022 ..... 7, 10
In re Pink, 34 N. Y. Supp. (2d) 758 32
In re Prudence Co. (*Reconstruction Finance Corporation* v. *Prudence Co., Inc.*), 90 F. (2d) 587 46
In re Reliable Estates, 33 F. Supp. 588 ..... 33, 35
In re Sorola Holding Corp. (E. D. N. Y. #27,904) 33
In re Schulte-United, 50 F. (2d) 243 39
In re 620 Church St. Corp., 299 U. S. 24 39
In re Suburban Properties, 110 F. (2d) 438 .... 14, 38
In re Truesdale Lake Corp. (S. D. N. Y. #62,215) 34
In re 24th Street Studio Building Corp. (S. D. N. Y. #61,556) 34
In re 25 East 77th Street Co. (S. D. N. Y. #60,978) 34
In re Walterarms Realty Co. (S. D. N. Y. #60,924) 34
In re Ware Metal Products, 42 F. Supp. 538 ..... 7, 38
In re Williamsport Wire Rope Co., 10 F. Supp. 481, aff'd 78 F. (2d) 1023 ..... 13, 39
In re Wisun & Golub, Inc., 84 F. (2d) 1 ..... 7, 8

Jacoby v. *Bond & Mortgage Guarantee Co.*, 72 F. (2d) 420, cert. den. 293 U. S. 619 ..... 33, 41

Kansas City Ry. v. *Cent. Union Tr. Co.*, 271 U. S. 445 36

Lincoln-Alliance Bank & Trust Co. v. *Dye*, 115 F. (2d) 234 40
Louisville Bank v. *Radford*, 295 U. S. 555 46

PAGE

Manati Sugar Co. v. *Mock*, 75 F. (2d) 284 ....10, 39, 40
Matter of Amawalk Nursery, Inc. (S. D. N. Y. #60,774) 35, 46
Matter of Ashwood Realty Corp. (S. D. N. Y. #60,455) (see 37 F. Supp. 670) 13, 34
Matter of Bond & Mortgage Guarantee Company (Paragon Land Corporation; Joseph P. Day), 288 N. Y. 270 15
Matter of Chelsea Presbyterian Church (S. D. N. Y. #73,084) 35
Matter of Dalton Schools, Inc. (S. D. N. Y. #80,480) 41, 47
Matter of 455 West 34th Street Corp. (S. D. N. Y. #61,923) 34
Matter of Jacksonville Gas Company and American Gas & Power Company (U. S. D. C., S. D. Fla.), decided September 22, 1942 30
Matter of Lawyers Mortgage Co., 277 N. Y. 244.. 24
Matter of New York Title & Mortgage Co., 153 Misc. 858 24
Matter of New York Title & Mortgage Co., 154 Misc. 447 24
Matter of New York Title & Mortgage Co. (Series F-1), 160 Misc. 283..... 17
Matter of People (Lawyers West Mtg. & Title Co.), 288 N. Y. 40 .....25, 32, 42
Matter of People (Tit. & Mtge. Guar. Co.), 264 N. Y. 69 .....41, 42
Matter of People (Westchester Tit. & T. Co.), 268 N. Y. 432 42
Matter of Wadsworth Gardens, Inc. (S. D. N. Y. #62,161) 35
Metropolitan Holding Company v. *Weadock*, 113 F. (2d) 207 37
Montgomery v. *M'Dermott*, 103 Fed. 801 43

O'Connor v. *Mills*, 90 F. (2d) 665 39

PAGE

Penn Co. v. *Pennsylvania*, 294 U. S. 189 11
Pennsylvania v. *Williams*, 294 U. S. 176 10
Plan L-25, Kings County Clerk's No. BMC 181,338 15
Plan 48-M, Kings County Clerk's No. BMC 181,010 15
Plan 202-M, Kings County Clerk's No. BMC 180,677 15
Plan 811-M, Kings County Clerk's No. BMC 215,572 15
Plan 1602, Kings County Clerk's No. LMG 29,159. 15
Plan 2073, Kings County Clerk's No. BMC 170,884 15
Plan 2956, Kings County Clerk's No. BMC 180,865 14
Plan 3521, Kings County Clerk's No. BMC 185,359 14
Plan 4612, Kings County Clerk's No. LTG 257,444 15
Plan 5164, Kings County Clerk's No. LMG 200,152 15
Price v. *Spokane Silver & Lead Co.*, 97 F. (2d) 237, cert. den. 305 U. S. 626 ..... 13, 39
Provident Mut. Life Ins. Co. v. *University Ev. L. Church*, 90 F. (2d) 992 ..... 10, 39

Reading Hotel Corp. v. *Protective Committee*, 89 F. (2d) 53, cert. den. 302 U. S. 742 ..... 14, 37
Reighard v. *Higgins Enterprises*, 90 F. (2d) 569 14, 39
R. L. Witters Associates v. *Ebsary Gypsum Co.*, 93 F. (2d) 746 36

San Francisco Laundry Ass'n v. *American Trust Company*, 127 F. (2d) 187 38
Scott v. *Mills*, 10 New York State Reporter 357 ... 44
Seaboard Terminals Corp. v. *Western Maryland Ry. Co.*, 108 F. (2d) 911 38
Securities Comm'n v. *U. S. Realty Co.*, 310 U. S. 434 7
Shapiro v. *Wilgus*, 287 U. S. 348 8
Sophian v. *Congress Realty Co.*, 98 F. (2d) 499 ... 37

Tennessee Pub. Co. v. *American Nat. Bank*, 299 U. S. 18 ..... 13, 36
Tolfree v. *New York Title & Mortgage Co.*, 72 F. (2d) 702, cert. den. 293 U. S. 619 33

PAGE

U. S. v. *Bank of New York Co.* ..10-11

Wayne United Gas Co. v. *Owe* *lass Co.*,
91 F. (2d) 827 ..... 14, 39

Weil v. *President and Directors* *f Manhattan Co.*,
275 N. Y. 238 ..... 24, 41

Wexford Realty Corp. v. *Manufacturers Trust Co.*,
263 App. Div. 971 14

Whitmore Plaza Corporation v. *Smith*, 113 F. (2d)
210 37

STATUTES:

Bankruptcy Act:
Sec. 77B (former 11 U. S. C. Sec. 207) 7

Chapter X:
Sec. 106 (11 U. S. C. 506) 41, 43
Sec. 130, subd. 7 (11 U. S. C. 530, subd. 7) ... 7
Sec. 141 (11 U. S. C. 541) 2, 7
Sec. 146 (11 U. S. C. 546) 2, 7, 9, 11, 12
Sec. 197 (11 U. S. C. 597) 41
Sec. 198 (11 U. S. C. 598) 45, 46
Sec. 212 (11 U. S. C. 612) 44
Sec. 216, subd. 7 (11 U. S. C. 616(7)) 40
Sec. 241 (11 U. S. C. 641) 28
Sec. 242 (11 U. S. C. 642) 28
Sec. 243 (11 U. S. C. 643) 28

Public Utility Holding Company Act of 1935 (15
U. S. C. 79k(e)) 30

Chapter 745, N. Y. Laws of 1933 (Schackno Act),
3, 4, 20, 32

Chapter 19, N. Y. Laws of 1935 ..... 4, 20

Chapter 704, N. Y. Laws of 1940 19

PAGE

McKinney's Unconsolidated Laws, Sec. 4815 19

McKinney's Unconsolidated Laws, Sec. 4819 19

McKinney's Unconsolidated Laws, Sec. 4878 32

New York Moratorium Laws (New York Civil Practice Act, Secs. 1077-a *et seq.*) 5

MISCELLANEOUS:

42 Yale Law Journal 591..... 27

49 Yale Law Journal 9..... 28

49 Yale Law Journal 1443, 1455..... 21

52 Harvard Law Review 1349, 1350..... 29

18 N. Y. U. Law Quarterly Review 399, 415, 417.. 26

House Report No. 3012, 74th Cong. 2d Sess. (1936) 28

Sen. Doc. No. 1916, 75th Cong., 3d Sess. (1938)..29, 45

Finletter: The Law of Bankruptcy Reorganization 7, 8, 40

Bouvier's Law Dictionary..... 44

Schumaker and Longsdorf's Cyclopedic Law Dictionary 44

Order of the Appellate Division Designating Additional Special Term, New York Law Journal July 31, 1933 19

The Administration of the Delinquent Title and Mortgage Guaranty Companies by the New York Insurance Department, a Survey by George S. Van Schaick, Superintendent of Insurance, dated May 10, 1935 .....18, 19, 23

PAGE

Annual Report of the Mortgage Commission, dated April 1, 1939, Legislative Document (1939) No. 94 ..... 17, 18, 26

Report of the Bureau of Trust Supervision to the Justice Presiding at Special Terms for the Reorganization of Guaranteed Certificated Mortgages in the Second Judicial District, filed in the office of the Clerk of Kings County, #5791/1940 ..... 17, 19, 20, 21, 22, 23, 26, 28

Report of George W. Alger, Commissioner, to His Excellency Herbert H. Lehman, Governor of the State of New York, dated October 5, 1934 ..... 23, 26

Reports of Joint Legislative Committee to Investigate the Guaranteed Mortgage Situation:

Legislative Documents (1934) Nos. 120 and 121 26

Legislative Document (1938) No. 87 29

Securities and Exchange Commission Report of June 18, 1936, Part VI 17, 18

Securities and Exchange Commission Report of September 30, 1940, Part VIII 8

The New York Times, September 27, 1942, Section 3, p. F-1, col. 8 30

IN THE

Supreme Court of the United States

OCTOBER TERM, 1942

No. 24

MARINE HARBOR PROPERTIES, INC.,
Petitioner,

MANUFACTURERS TRUST COMPANY (successor by merger to The Mortgage Corporation of New York), as trustee for the benefit of certificate holders in mortgage guaranteed by Bond and Mortgage Guarantee Company, Guarantee #181,568,
Respondent,

MAURICE RUBINGER, trustee of Marine Harbor Properties, Inc.,

SAMUEL SILVERMAN, additional trustee of Marine Harbor Properties, Inc.,

MORTIMER RUBENSTEIN, foreclosure-receiver,
and

SECURITIES AND EXCHANGE COMMISSION.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF OF RESPONDENT MANUFACTURERS TRUST COMPANY AS TRUSTEE

Opinions Below

The opinion of the district court (Bright, *D. J.*) is contained in the record (R. 70-75) and is also reported in 41

F. Supp. 814. The majority (Swan, *C. J.* and Chase, *C. J.*) and dissenting (Frank, *C. J.*) opinions of the Circuit Court of Appeals are contained in the record (R. 107-126) and are also reported in 125 F. (2d) 296.

Jurisdiction

The jurisdiction of this court rests upon Section 240(a) of the Judicial Code, as amended by the Act of February 13, 1925.

Statutes Involved

Section 141 of Chapter X of the Bankruptcy Act (11 U. S. C. 541) provides:

> "§ 141. PETITION OF DEBTOR
>
> Upon the filing of a petition by a debtor, the judge shall enter an order approving the petition, if satisfied that it complies with the requirements of this chapter and has been filed in good faith, or dismissing it if not so satisfied."

Section 146 (11 U. S. C. 546) provides in part as follows:

> "§ 146. GOOD FAITH OF PETITION
>
> Without limiting the generality of the meaning of the term 'good faith', a petition shall be deemed not to be filed in good faith if—
>
> * * * * * * *
>
> (3) it is unreasonable to expect that a plan of reorganization can be effected; or
>
> (4) a prior proceeding is pending in any court and it appears that the interests of creditors and

stockholders would be best subserved in such prior proceeding."

Statement of the Case

Manufacturers Trust Company (successor by merger to The Mortgage Corporation of New York) is trustee for the benefit of certificate holders of a first mortgage in the present principal amount of $370,000 covering the land and apartment house building at 351-363 Marine Avenue, Brooklyn, New York, which is the debtor's sole asset* (R. 7). The debtor, a New York corporation formed by Abraham and Gussie Hammer, husband and wife, all of the stock of which is now owned by Gussie Hammer, acquired the real estate in February 1933 (R. 76, 95, 61, 8-9, 66).

The mortgage was executed in 1931 in favor of Title Guarantee and Trust Company, which sold participation certificates in the bond and mortgage to the general public. These participation certificates were guaranteed as to principal and interest by Bond and Mortgage Guarantee Company, which was taken over on August 2, 1933 for rehabilitation by the Superintendent of Insurance of the State of New York (R. 8). Pursuant to powers granted to him as rehabilitator of Bond and Mortgage Guarantee Company under Sections 3 and 4 of Chapter 745 of the New York

---

*The petitioner, in the opening sentence of its statement, refers to the apartment building as its "principal asset", but in paragraph 7 of its petition under Chapter X it swore "The debtor has no cash and no assets other than the property [apartment house] above referred to" (R. 82). The Securities and Exchange Commission has fallen into the same error in its statement (p. 4).

Laws of 1933 as amended (the Schackno Act), the Superintendent of Insurance on October 24, 1934 promulgated a plan for the readjustment, modification and reorganization of the rights of certificate holders in the mortgage, which plan provided for an extension of the mortgage indebtedness and a reduction of the interest rate thereon (R. 9).

The debtor entered into an agreement embodying the plan, appeared at the hearing on such plan in the Supreme Court, Kings County, by its then president Abraham Hammer, and consented in open court to the plan as modified by the court (R. 9, 49-51). Thereafter, more than 66⅔% of the holders in principal amount of certificates in such mortgage having consented to such plan as modified by the court, it became binding upon all parties in interest, including the debtor (R. 10, 53).

In 1938 the New York Mortgage Commission, by virtue of its powers under Chapter 19 of the New York Laws of 1935 (the Mortgage Commission Act), promulgated a further plan to modify the original plan promulgated by the Superintendent of Insurance to the extent of appointing a trustee of the bond and mortgage under an approved form of declaration of trust (R. 11). The debtor received notice of such plan and hearing thereon (R. 11). After hearing in the Supreme Court, Kings County, and upon the approval of more than 66⅔% in principal amount of certificate holders, a final order was entered on December 6, 1938 approving the plan and the form of declaration of trust and designating The Mortgage Corporation of New York as trustee (R. 11, 42).

In such final order, the Supreme Court, Kings County, retained jurisdiction of the proceedings through the following clause (R. 12, 44):

"ORDERED that this Court, having assumed jurisdiction of this proceeding, *shall retain jurisdiction hereof until the complete liquidation of the Trust Estate* and the termination of the trust; and the Trustee, or *any other interested party herein, may apply at the foot of this Final Order* upon such notice as the Court may direct *for such other and further relief as to the Court may seem just and proper.*"*

Pursuant to such final order, The Mortgage Corporation of New York duly qualified as trustee and the bond and mortgage were assigned to it by Title Guarantee and Trust Company and the Mortgage Commission (R. 12). Thereafter and until April 1941, when it defaulted in the payment of interest and taxes, the debtor made payments to the trustee in conformity with the final order approving the modified plan (R. 78-9).

Following the maturity of the mortgage on December 1, 1937, it ~~ran~~ "open" (R. 10, 8, 17). No principal amortization was required because of the New York Moratorium Laws (*New York Civil Practice Act, Sections 1077-a et seq.*). Earnings of approximately 6⅔% after taxes were more than sufficient to pay the mortgage interest of 5% (R. 16). The mortgage was exceedingly top-heavy. The principal amount of such mortgage, together with arrears of interest and taxes, was $384,931 on April 1, 1941, and $399,814.93 on October 1, 1941, while the value of the mortgaged premises did not exceed $350,000 (R. 15, 17, 56-57, 60, 71). Thus, entirely apart from the second, third and fourth mortgages and the balances due on conditional bills of sale, there was a deficit of approximately

*Italics in quotations in this brief are supplied unless otherwise noted.

$35,000 on April 1, 1941, and of approximately $50,000 on October 1, 1941. The debtor and the trustee had been negotiating on some plan which might prove feasible for further extension and modification of the mortgage (R. 14). The trustee took the position that in view of the top-heavy condition of the mortgage a fair plan would require the debtor to turn over substantially all of the earnings of the property to certificate holders. The debtor refused to meet such conditions (R. 14). Thereupon the debtor, instead of availing itself of the privilege of going into the state court which had retained jurisdiction of the matter, with a proposal for extension and modification of the mortgage, wilfully defaulted in the payment of interest and taxes despite the fact that earnings were sufficient to make such payments (R. 12, 16).

After the trustee's institution of the foreclosure action on May 1, 1941, the debtor further defaulted with respect to certain promises which it made for the clearing up of arrears and settlement of the foreclosure proceeding (R. 58-59). After the foreclosure action had proceeded for 4½ months with a state court receiver in possession, the debtor obtained an order *ex parte* approving its petition for "reorganization" under Chapter X (R. 96-101, 6).

Question Presented

The issue here is whether or not a mortgagor (debtor), whose only asset is a piece of improved real property encumbered by a certificated first mortgage greater in amount than the value of the mortgaged property, may force the first mortgagee into a Chapter X proceeding despite the fact that proceedings which are specially designed to safe-

guard the rights of the first mortgage certificate holders and in which the debtor has participated are pending in the state court.

Argument

The court, before approving a debtor's petition under Chapter X, must be "satisfied" that the "need for relief under this chapter" exists and that the petition has been filed in good faith in the general sense of that term as well as in the four specifically designated senses contained in the subdivisions of Section 146. (*Section 130, subdivision 7; Section 141; Section 146; 11 U. S. C. 530, subdivision 7, 541, 546*). The courts have often dismissed 77B and Chapter X proceedings under the general statutory provisions codifying their broad equity powers, when they have not believed that entertainment of the petition was warranted under existing circumstances. *In re North Kenmore Bldg. Corp.*, 81 F. (2d) 656 (C. C. A. 7th); *In re Wisun & Golub, Inc.*, 84 F. (2d) 1 (C. C. A. 2nd); *In re Philadelphia Rapid Transit Co.*, 8 F. Supp. 51, 55 (D. C., E. D. Pa.), aff'd 73 F. (2d) 1022; *In re Cook*, 104 F. (2d) 981, 985 (C. C. A. 7th); *In re Ware Metal Products*, 42 F. Supp. 538 (D. C., D. Mass.); see *Securities & Exch. Commission* v. *United States R. & Imp. Co.*, 310 U. S. 434, 455; *In re Julius Roehrs Co.*, 115 F. (2d) 723 (C. C. A. 3rd); *Finletter: The Law of Bankruptcy Reorganization* (1939), pages 73-85. In some instances, when the petition under Section 77B or Chapter X has been filed by a debtor, rather than by creditors who could have done so, the courts have dismissed the proceedings because of the personal disqualification of the debtor. *Brooklyn Trust Co. v. Rembaugh*, 110 F. (2d) 838, 840 (C. C. A. 2nd) (debtor

participated in prior state court proceedings); *In re Blinrig Realty Corporation*, 114 F. (2d) 100 (C. C. A. 2nd) (debtor participated in prior state court proceedings); *In re Wisun & Golub, Inc.*, 84 F. (2d) 1 (C. C. A. 2nd) (debtor concealed assets); *In re North Kenmore Bldg. Corporation*, 81 F. (2d) 656 (C. C. A. 7th) (debtor incorporated to file petition); *In re Francfair, Inc.*, 13 F. Supp. 513 (S. D. N. Y.) (debtor incorporated to file petition). See also *Shapiro* v. *Wilgus*, 287 U. S. 348. The very fact that a debtor, as petitioner in the instant case, although insolvent in the bankruptcy sense, is able to meet its current obligations as they mature may be sufficient reason for dismissal of its petition to "reorganize" under Chapter X. See *First Nat. Bank* v. *Flershem*, 290 U. S. 504, 516-519; *Finletter: The Law of Bankruptcy Reorganization* (1939), page 38: "* * * it is believed that few petitions [under Chapter X] will be granted on the basis of asset-liability insolvency unless the debtor is also unable to meet its current obligations."

The Securities and Exchange Commission Report of September 30, 1940, Part VIII, contains the following significant comments (pp. 94, 97):

> "In still other contexts, perhaps also reflecting no 'need for relief' under Section 77B, debtors' petitions were found lacking in 'good faith.' Thus, in instances where reorganization was near completion in pending equity receivership or foreclosure proceedings, courts refused to approve debtor's petitions which would have disrupted such proceedings. * * * In all these cases, it is apparent that the debtor's petition represented a last-ditch effort to salvage some interest which the equity proceeding would have denied to it; and the action of the courts

in these situations is further indication that Section 77B was not a mechanism for preserving equities at the expense of creditors. Rather, the 'need for relief' which a debtor was obliged to show was a need for the machinery of 77B as an essential in accomplishing a reorganization because other procedures were either unavailable or more cumbersome and expensive. In the cases cited, it was the debtor's inability to show this, other procedures having been successfully utilized, that led the courts to find an absence of 'good faith.'

* * * * * * *

[after citing further cases interpreting "good faith"]

These cases exemplify both the flexibility and the usefulness of the concept 'good faith' in connection with debtor's proceedings under Section 77B. Unquestionably its pliable character equipped the courts with a valuable power to sift and sort the cases with which they were presented.[67] In some respects, however, the power perhaps might have been utilized to a greater extent than the reported cases show."

"[67] In the revision of Section 77B contained in Chapter X of the amendatory Act, the flexibility of the provision is retained, while at the same time there is incorporated a codification of the interpretations given to it by the courts. Section 146 of the Act reads as follows: [quoting statute]."

Petitioner has the burden of establishing the need for relief under Chapter X and also its good faith in the general sense as well as in the four specific senses enumerated in the subdivisions of Section 146, and judicial approval of the petition should not be based solely upon the allegations of the petition but upon an independent

inquiry into the petitioner's good faith. *Manati Sugar Co.* v. *Mock*, 75 F. (2d) 284 (C. C. A. 2nd); *In re Cook*, 104 F. (2d) 981, 984 (C. C. A. 7th); *Hickey* v. *Ritz-Carlton Restaurant & Hotel Co.*, 96 F. (2d) 748, 751 (C. C. A. 3rd); *In re Grigsby-Grunow Co.*, 77 F. (2d) 200 (C. C. A. 7th); *Provident Mut. Life Ins. Co.* v. *University Ev. L. Church*, 90 F. (2d) 992, 995 (C. C. A. 9th); *In re Philadelphia Rapid Transit Co.*, 8 F. Supp. 51 (D. C., E. D. Pa.), aff'd 73 F. (2d) 1022. The mere *ex parte* approval of the petition by the district judge made upon a petition failing to disclose the terms of the state court order (R. 78, 80) can not cast the burden of proof upon respondent-trustee, and the cases cited by petitioner for that contention (its brief, p. 13) support rather than negative our view.

Since it is uncontroverted and the district court found (R. 70-71) that the indebtedness on the first mortgage is substantially greater in amount than the value of the mortgaged premises, the only proper subject of reorganization is the certificated mortgage which is already within the jurisdiction of the comprehensive procedure existing in the state courts. The case is therefore analogous to those cases in which this court and other federal courts have consistently ruled that, where there is a state statutory procedure available for the liquidation of corporations under the jurisdiction of state officers, the federal courts should relinquish jurisdiction "in favor of the statutory administration of the corporate assets by the state officer" in the absence of a showing by the party requesting the federal court to take jurisdiction that the interests of creditors and stockholders would not be adequately protected by the state court procedure. *Pennsylvania* v. *Williams*, 294 U. S. 176, 183; *Gordon* v. *Ominsky*, 294 U. S. 186; *U. S.* v. *Bank*

cf New York Co., 296 U. S. 463. Thus, in *Penn Co.* v. *Pennsylvania*, 294 U. S. 189, this court said (p. 197):

> "In the absence of a showing that the interests of creditors and shareholders would not be adequately protected by this procedure, the case was a proper one for the district court, in the exercise of judicial discretion, to relinquish the jurisdiction in favor of the administration by the state officer. See No. 394, *Pennsylvania* v. *Williams, supra.*"

It was in accordance with such principles that the majority of the Circuit Court of Appeals ruled: "That [the pending state court] proceeding provides adequate means to reorganize the mortgage and protect the rights of all certificate holders whose interests alone exhaust the debtor's property." (R. 110).

FIRST. The dismissal of the petition was correct, because prior proceedings are pending in which it appears that the interests of creditors and stockholders would be best subserved.

Preliminarily, it must be noted that while subdivision (4) of Section 146 mentions the interests of stockholders as well as of creditors, in the instant case, as was pointed out in both the majority and dissenting opinions of the Circuit Court of Appeals (R. 110, 115), under the doctrine of "absolute priorities" adhered to by this court, the interests of the first mortgage creditor need alone be considered. *Case* v. *Los Angeles Lumber Products Co.*, 308 U. S. 106; *Consolidated Rock Products Co.* v. *DuBois*, 312 U. S. 510.

A. The proceedings pending in the New York State Supreme Court are "prior proceedings" within the meaning of Section 146, subdivision (4).

Neither the dissenting opinion of the Circuit Court of Appeals (R. 113, 115-126), nor the opinion of the district court (R. 73-75), questioned the fact that the trust proceeding pending in the State Supreme Court was a "prior proceeding" within the meaning of Section 146, subdivision (4). But the debtor and the Securities and Exchange Commission now argue (*Petitioner's Brief*, pp. 11-13, 19-22; *Securities and Exchange Commission Brief*, p. 21) that these are not such prior proceedings, the former because the order appointing the trustee was a "final" order terminating "all prior proceedings in the state court for good and always" and because the debtor had "no standing in [the] Schaekno proceedings" (*Petitioner's Brief*, pp. 13, 22); and the latter because its concept of "prior proceedings" is that of a "proceeding in which the assets of a debtor were *in custodia legis* for the primary purpose of rehabiiitation or distribution for the benefit of claimants" (*Securities and Exchange Commission Brief*, p. 21, n. 21). None of these grounds is tenable.

That the state court proceeding was not terminated is shown by the order quoted *supra*, page 5. The argument of the Securities and Exchange Commission is not supported by the definition contained in the statute itself. But, apart from this and assuming *arguendo* that the argument might have some force if the debtor possessed other assets which would come into the custody of the federal reorganization court and which were not in the custody or under the jurisdiction of the state court, it is wholly unfounded where

as here the first mortgage, which completely exhausts the debtor's property, is under the jurisdiction of the state court both in the Schackno trust proceeding and in the foreclosure proceeding.

The language of subdivision (4) is broad; it is only required that "*a* prior proceeding" be pending, etc.; there is no requirement that the proceeding be of any particular type nor that the debtor shall have participated to any particular degree. In many instances where various types of state or federal "reorganization" proceedings have been pending, petitions under Chapter X and under Section 77B have been dismissed. *Tennessee Pub. Co.* v. *American Nat. Bank*, 299 U. S. 18, 21 (where district court had ruled "that it would 'manifestly be unjust to the bondholders' to undo what had been done in the equity case" and its order dismissing 77B petition was affirmed); *Brooklyn Trust Co.* v. *Rembaugh*, 110 F. (2d) 838 (C. C. A. 2nd) (Schackno Act trust proceeding pending in state court); *In re Bliirig Realty Corp.*, 114 F. (2d) 100 (C. C. A. 2nd) (Schackno Act trust proceeding pending in state court); *In re Paloma Estates, Inc.*, 126 F. (2d) 72 (C. C. A. 2nd) (Schackno Act trust proceeding pending in state court); *Price* v. *Spokane Silver & Lead Co.*, 97 F. (2d) 237 (C. C. A. 8th), cert. den. 305 U. S. 626 (state court receivership pending); *In re Williamsport Wire Rope Co.*, 10 F. Supp. 481 (D. C., M. D. Pa.), aff'd 78 F. (2d) 1023 (federal equity receivership pending); *In re Cook*, 104 F. (2d) 981 (C. C. A. 7th) (state court accounting suit pending); *In re Mallalieu & Conrey, Inc.*, 10 F. Supp. 808 (D. C., E. D. Pa.) (federal equity receivership pending); *In re Ashwood Realty Corp.*, N. Y. L. J., February 25, 1939; see 37 F. Supp. 670 (Schackno Act proceeding pending); *cf. Harkin* v. *Brundage*, 276 U. S. 36.

Moreover, the pendency of a state foreclosure proceeding has often been considered ground for dismissal of a petition under former Section 77B or under Chapter X, when the interest of the mortgagee conducting the foreclosure completely exhausts the property. *Wayne United Gas Co.* v. *Owens-Illinois Glass Co.*, 91 F. (2d) 827, 829 (C. C. A. 4th); *In re Suburban Properties*, 110 F. (2d) 438 (C. C. A. 7th); *Reighard* v. *Higgins Enterprises*, 90 F. (2d) 569 (C. C. A. 3rd); *In re Corn Kelly Corporation*, 32 F. Supp. 572 (D. C., E. D. N. Y.), aff'd 111 F. (2d) 644; *In re Francfair, Inc.*, 13 F. Supp. 513 (D. C., S. D. N. Y.). See also *Reading Hotel Corp.* v. *Protective Committee*, 89 F. (2d) 53 (C. C. A. 3rd), cert. den. 302 U. S. 742; *First Nat. Bank* v. *Conway Road Estates Co.*, 94 F. (2d) 736 (C. C. A. 8th), cert. den. 304 U. S. 578; *In re Murel Holding Corporation*, 75 F. (2d) 941 (C. C. A. 2nd).

The debtor's present argument that it has no standing in the state court is an afterthought. It never endeavored to assert any rights in the state court. If it had endeavored to proceed in the state court, it would have found that its right to do so is not open to question. *Wexford Realty Corp* v. *Manufacturers Trust Co.*, 263 App. Div. 971 (2nd Dept.) — appeal by owner-mortgagor; *Crane, Metro Estates, Inc., et al.* v. *Brooklyn Trust Co.*, 262 App. Div. 969 (2nd Dept.); *Feinstein, et al.* v. *The Mortgage Corporation of New York*, 264 App. Div. 783 (Mem.); *Plan 3521, Kings County Clerk's No. BMC 185,359, Premises 494 Sheffield Avenue, Brooklyn, New York*—after denial of extension application made by trustee, owner moved for reargument and application was granted; *Plan 2956, Kings County Clerk's No. BMC 180,865, Premises 301—81st Street, Brooklyn, New York*—owner moved, at the foot

of "final order" apprpving plan and appointing trustee, to alter plan with respect to tax payments and motion was granted; *Plan L-25, Kings County Clerk's No. BMC 181,338, Premises 1539 Bergen Street, Brooklyn, New York; Plan 1602, Kings County Clerk's No. LMG 29,159, Premises 292 to 304 Midwood Street, Brooklyn, New York; Plan 2073, Kings County Clerk's No. BMC 170,884, Premises 5619—15th Avenue, Brooklyn, New York; Plan 48-M, Kings County Clerk's No. BMC 181,010, Premises West Side of First Avenue, between north side of 58th Street and south side of 57th Street, Brooklyn, New York; Plan 202-M, Kings County Clerk's No. BMC 180,677, Premises 162-04 Jamaica Avenue, Jamaica, Queens, New York; Plan 811-M, Kings County Clerk's No. BMC 215,572, Premises 325 Bowery, Manhattan, New York; Plan 5164, Kings County Clerk's No. LMG 200,152, Premises 353 to 347 Fourth Street, Brooklyn, New York; Plan 4612, Kings County Clerk's No. LTG 257,444, Premises 99 Ocean Avenue, Brooklyn, New York;* see also *Matter of Bond & Mortgage Guarantee Company (Paragon Land Corporation; Joseph P. Day)*, 288 N. Y. 270.

B. The pending proceedings in the state court will best subserve the interests of creditors*.

It must be emphasized at the outset that this is not the case of a debtor corporation with a complicated financial

*The suggestion in the brief of the Securities and Exchange Commission (p. 4) that its presentation of the case "has been broadened" because of our statement in our letter dated March 28, 1942 written to the clerk of this court, is surprising. The complete sentence from which the brief quotes was:

"In view of the intervention of the Securities & Exchange Commission *and the position taken by it in its*

structure engaged in a business involving the creation and maintenance of good will, in which event its creditors and stockholders would probably benefit from the elaborate mechanism prescribed by Chapter X and explained in detail

---

> *memorandum in support of the petition for writ of certiorari*, this case is generally regarded as involving a test as to whether approximately $700,000,000 in principal amount of certificated mortgages covering real estate in New York City and immediately adjoining counties will be reorganized under a procedure established by the New York Legislature or pursuant to the procedure provided in Chapter X of the National Bankruptcy Act."

In the memorandum referred to, the Securities and Exchange Commission indicated for the first time that it considered this case a test case, stating in such memorandum (pp. 12-13):

> "5. The importance of the issue involved in this case is manifest. Thousands of certificated mortgage issues are being 'reorganized' in the state courts, and many of these 'reorganizations' have taken the form, as in the present case, of a short extension of the maturity of the mortgage. As these extensions expire, further 'reorganization' is needed. The decision in the present case will, to a large extent, determine whether the federal procedure provided by Chapter X shall be available for such further reorganization."

The Securities and Exchange Commission did not intervene in this proceeding until after the decision of the district court, and when the case was in the district court it was not known that efforts would be made to make it a test for determining generally the question of jurisdiction between state and federal courts with respect to "Schackno mortgages".

While we believe that the burden of showing the advantages of a Chandler Act proceeding over a continuation of the proceedings in the state court rests upon petitioner, we shall, for the information of the court, present herewith certain material contained in public documents compiled during the course of ten years of state certificated mortgage reorganizations, which we believe demonstrates conclusively that at least in this case the interests of creditors will be best subserved by a dismissal of this petition and a continuation of the proceedings in the state court.

in the dissenting opinion (R. 116-123). This is the case of a debtor corporation owned by one person and formed to hold a single piece of real property, its only asset, the value of which is far exceeded by the amount of its first mortgage indebtedness.

The first mortgage has been permanently reorganized pursuant to a statutory scheme, worked out by the New York authorities after several years of study, by the appointment of a trustee under an approved uniform form of declaration of trust. *Annual Report of the Mortgage Commission dated April 1, 1939, N. Y. Legislative Document (1939) No. 94.* From May 1, 1935 to March 31, 1939, 13,511 certificated mortgages in the aggregate principal amount of $583,060,045 had been reorganized in the State Supreme Court pursuant to the Schackno Act or Mortgage Commission Act*, for the most part by the appointment or election of permanent trustees acting under the standard form of declaration of trust.** From September 1933 to

---

*Debtor-petitioner is incorrect in its statement that Schackno proceedings were instituted "to rehabilitate or liquidate various bond and mortgage companies that had become insolvent and defunct" (*Petitioner's Brief*, p. 6). In reality, those Acts, by their very terms, were designed primarily to provide a vehicle for the permanent reorganization of the rights of certificate holders in particular mortgages or groups of mortgages.

**This form of declaration of trust was devised after many consultations between the courts handling certificated mortgage matters, the Mortgage Commission, the Insurance Department and attorneys specializing in this field and representing certificate holders (*Report of the Bureau of Trust Supervision*, p. 7, see *infra*, p. 20; *Matter of New York Title and Mortgage Co. (Series F-1)*, 160 Misc. 283). Although there were slight differences between the forms employed in some of the various counties of the metropolitan area, these differences are of no materiality here. *Report of June 18, 1936 of the Securities and Exchange Commission*, p. 185, n. 1, see *infra* p. 18.

May 1, 1935, $324,850,161.59 principal amount of certificated mortgages, involving over 100,000 investors, had been partially or fully reorganized in the same manner. *The Administration of the Delinquent Title and Mortgage Guaranty Companies by the New York Insurance Department, a Survey by George S. Van Schaick, Superintendent of Insurance, dated May 10, 1935*, p. 43; *Annual Report of the Mortgage Commission dated April 1, 1939, supra*, p. 17.

In the report of June 18, 1936 of the Securities and Exchange Commission on the Study and Investigation of Reorganization Committees, which study and investigation was headed by Mr. (now Mr. Justice) William O. Douglas, it is stated (Part VI, p. 185):

> "An unusually active type of trusteeship exists in New York State, in connection with the reorganization of issues of guaranteed mortgage certificates. Under the standardized form of declaration of trust, used with only minor modifications in dozens of these reorganizations, the trustee purports to be under a higher standard of obligation to the security holders than trustees under other indentures. Furthermore, he has express authorization to perform a broad range of acts looking toward future reorganization. This type of trusteeship has developed out of a situation of unique complexity and peculiar difficulty. However, many features of the trusteeship itself seem to have no inherent restriction either to the type of security or the type of procedure wherein it originated, and it is therefore a suggestive analogy for other trusteeships, particularly in the field of real estate securities."

This trust instrument, set forth at length in the record at pages 22-37, which was adopted with the consent of more than two-thirds in principal amount of the certificate

holders* and the approval of the court (R. 11, 42), is admirably adapted to the purpose for which it was created. Under it, the trustee is given broad powers and at the same time large responsibility in the handling of the certificated mortgage. The trustee must account annually (R. 27; *McKinney's Unconsolidated Laws*, Section 4815). It cannot extend or modify the bond and mortgage of which it is trustee nor sell the underlying property in the event of foreclosure without the permission of the court obtained "in said reorganization proceeding" after notice by mail to certificate holders. The trust is under the supervision of the Supreme Court, Kings County, where Mr. Justice George E. Brower, designated by the Appellate Division, Second Judicial Department, to preside over all certificated mortgage matters, has passed upon all such matters for almost ten years. *McKinney's Unconsolidated Laws*, Section 4819; *Order of the Appellate Division designating additional special term, New York Law Journal, July 31, 1933; The Administration of the Delinquent Title and Mortgage Guaranty Companies, supra*, p. 16; *Report of the Bureau of Trust Supervision, infra.*

By Chapter 704 of the Laws of 1940, the legislature authorized the creation of the Bureau of Trust Supervision. It, in effect, was to supersede the Mortgage Commission, which had then gone out of existence, in the performance of advisory services to the courts supervising certificated mortgage matters. Its excellent work through experienced personnel in advising the court on annual ac-

---

*The statement in petitioner's brief (p. 17), that certificate holders were "against their will * * * dragged into the State Schackno proceedings", is, to say the least, misleading, as is the conclusion of the dissenting opinion (R. 125).

counts, on extensions and modifications of mortgages, on sales of foreclosed properties and in other related matters, is set forth in detail in its report to the Justice presiding over certificated mortgage matters in the Second Judicial District, entitled *Report of the Bureau of Trust Supervision to the Justice Presiding at Special Terms for the Reorganization of Guaranteed Certificated Mortgages in the Second Judicial District*, filed in the office of the Clerk of Kings County, #5791/1940. Upon the argument, copies of such report will be made available to the Court for its information, so the contents thereof will not be discussed in detail here.

As indicated in the Bureau's report, the trustee, normally (as in this case, R. 20) endeavors to obtain an extension and modification of the mortgage upon terms assuring to certificate holders substantially all of the income which the property yields unless the owner has an equity in the property entitling it to a share of the income.*

If terms can be agreed upon which are satisfactory to the court and certificate holders, an extension and modification agreement is entered into between the trustee and the debtor after a hearing upon notice to certificate holders in which the Bureau of Trust Supervision participates. Full information as to the appraised value of the property, its assessed value, its physical condition, neighborhood conditions, and earnings of the property, as checked by the trustee's auditors and appraisers and by the Bureau of Trust

*It should be noted that certificate holders for the most part acquired their certificates by paying par for them before the collapse of the mortgage guaranty companies in 1932, while property owners often, as is apparently the fact in this case, acquired their "equities" as a speculation during the depression (R. 8; see Chapter 745, N. Y. Laws of 1933; Chapter 19, N. Y. Laws of 1935).

Supervision, is furnished to certificate holders and the court (*Report of the Bureau of Trust Supervision, supra*, p. 15). All expenses of such proceeding are paid by the debtor, except for a nominal charge of the Bureau of Trust Supervision, which is paid out of the trust (*Report of the Bureau of Trust Supervision, supra*, pp. 6, 15, 9 [footnote]). The declaration of trust limits the trustee's fees to the commissions therein specified and permits no fees to attorneys except in the unusual event of actual legal proceedings, in which event they are subject to court approval (R. 29-30).

If a fair extension and modification arrangement cannot be worked out with the property owner* and the situation is hopeless, a foreclosure or taking of a deed in lieu of foreclosure from the owner are the only alternatives. In case of a deed in lieu of foreclosure, title is ordinarily

---

*The Securities and Exchange Commission contends (its brief, pp. 24-25) that the state procedure is inadequate, because it provides for "short extensions of the mortgages" without requiring "payment" or "refunding". Of course, the term of the extension is within the discretion of the state court and depends upon the circumstances of the particular case (R. 26). If it is feasible to refinance the mortgage and liquidate it by full or adequate partial payment to certificate holders, such a plan also can be presented to the state court (R. 26). In many cases, where the debtor has sufficient equity to permit a refinancing, liquidation has been accomplished in this manner (*Report of Bureau of Trust Supervision, supra*, pp. 12-14). The state court follows the doctrine of absolute priorities enunciated by this court, *Chase Nat. Bank* v. *10 E. 40th St. Corp.*, 238 App. Div. 370 (1st Dep't); *Clinton Trust Co.* v. *142-144 Joralemon Street Corp.*, 237 App. Div. 789 (2nd Dep't); 49 Yale Law Journal 1443, 1455, and will not permit a debtor who has no equity, as in the instant case, to formulate a liquidation plan which will take anything away from the senior claimants, the certificate holders, whose interests exhaust the debtor's property. Therefore, in cases like the present, relatively short extensions of the mortgage or foreclosure are the only feasible alternatives.

obtained in a few days with practically no expense; in case the owner will not voluntarily execute a deed or subordinate liens must be cut off and foreclosure is necessary, title is ordinarily obtained by the trustee within a period of from three to five months. Foreclosure fees and expenses are passed upon by the court (*Report of the Bureau of Trust Supervision, supra,* p. 9). Since the trust is specifically a liquidating trust (R. 30-31), the trustee endeavors to dispose of the premises to which it has thus acquired title as soon as a reasonable offer can be obtained. In many instances, the trustee takes back a purchase money mortgage for part of the purchase price from the purchaser of the premises and in such instances the purchase money mortgage becomes a part of the trust estate (*Report of the Bureau of Trust Supervision, supra,* p. 13). We do not presume it will be argued that Messrs. Rubinger and Silverman, the trustees appointed by the District Court, could more effectively sell the mortgaged premises than could Manufacturers Trust Company with its large experience in real estate matters and expert personnel (see *Report of the Bureau of Trust Supervision,* pp. 7, 16, 18).

When foreclosure becomes necessary or title is taken through a deed in lieu of foreclosure and repairs have to be made and taxes and insurance premiums paid, the trustee often has to advance substantial sums* of its own money for such purposes, which of course are recouped whenever possible out of the proceeds of the trust properties (*Report*

---

*According to the report of the Bureau of Trust Supervision as of December 31, 1941, the corporate trustees in the Second Judicial District had advances outstanding made from their own corporate funds to the various trust estates for the purpose of paying taxes, insurance, disbursements, etc. of $1,067,532.65.

of the Bureau of Trust Supervision, supra, p. 19; R. 25-27, Articles II, V).

As against this inexpensive, efficient and simple procedure which in every way completely protects the certificate holders whose interests alone need to be considered in this case, the debtor and the Securities and Exchange Commission endeavor to set the so-called "safeguards" of a Chapter X proceeding. These might well be valuable in a proceeding involving an industrial corporation with several outstanding issues of stocks and bonds, but they are not at all applicable in this instance.

The debtor argues that under a Chapter X proceeding foreclosure would not be necessary (*Petitioner's Brief,* 7) for the acquisition of title, and the dissent in the Circuit Court of Appeals argues that a plan can be effected whereby "without the expense or delay involved in foreclosure, the property will promptly be turned over to a new company, having no debts, all of the stock being ratably distributed among the certificate-holders" (R. 114). This is the so-called corporate method of reorganization, which was tried in the state courts some years ago and found wanting. *The Administration of the Delinquent Title and Mortgage Guaranty Companies, supra,* pp. 39-40; *Report of George W. Alger, Commissioner, to His Excellency Herbert H. Lehman, Governor of the State of New York, dated October 5, 1934,* p. 77. To organize a corporation and pay corporation taxes would be fruitless and far more expensive than the present trusteeship. There would be no protection by the court for certificate holders after the corporation was once launched. The problem of converting numerous certificate holders into stockholders and enabling them to select

directors who could and would operate the property honestly, expertly and efficiently is a difficult one. The establishment of a fiduciary relationship with a trained responsible trustee and the retention of supervision by the court has been found to be superior to any other method. *Matter of New York Title & Mortgage Co.*, 153 Misc. 858, 864-866; see also *Matter of New York Title & Mortgage Co.*, 154 Misc. 447; *Matter of Lawyers Mortgage Co.*, 277 N. Y. 244. If certificate holders must terminate the mortgage because of the debtor's wilful default, what method is simpler and cheaper than to have the trustee conclude the foreclosure proceeding which has already proceeded for 4½ months in the state court?*

It is further argued that a Schackno trustee is not "able to cope with a debtor's fraud or dishonesty", and that the Schackno trustee does not "possess power to investigate and probe the debtor as to its past management or its future prospects" (*Petitioner's Brief*, p. 7). But *Weil, et al.* v. *President and Directors of Manhattan Company*, 275 N. Y. 238, cited by petitioner, merely held that a Schackno trustee was not vested with the right to prosecute claims, owned by

*The Securities and Exchange Commission argues (its brief p. 26) "that the foreclosure must either end in a forced sale * * * or it must serve as the procedural vehicle for a reorganization according to the well-known pattern of equity receiverships", and that "it was this very type of inadequate equity procedure which Chapter X" was designed to supplant. The Commission misapprehends the simple procedure followed in New York State upon the foreclosure of an ordinary real estate mortgage. As hereinbefore explained, there is no involved judicial reorganization, nor is there any "forced sale"; there is simply the acquisition of legal title by the Schackno trustee through its usually nominal bid at the foreclosure sale, the property thereupon becoming the corpus of the trust.

individual certificate holders, for past breaches of trust by a depositary. It did not hold that *class* claims belonging to all certificate holders were not vested in a Schackno trustee. Such claims, which would include any action brought for the benefit of all certificate holders predicated upon the debtor's fraud or dishonesty, would, by the very terms of the declaration of trust, be vested in the Schackno trustee (R. 24). See *Matter of People* (*Lawyers Westchester Mortgage and Title Company*), 288 N. Y. 40. This, however, is academic in the present case, as it would be in most Schackno trust cases, because the debtor is a mere shell, hopelessly insolvent, with no asset other than this apartment house (R. 82). There is no reason to believe that a right of action against corporations holding mortgaged premises in cases of this type is of any value.

The debtor (*Petitioner's Brief,* p. 14) and the dissenting opinion in the Circuit Court of Appeals (R. 113) argue that the respondent may be motivated by selfish interests in seeking to have "the state court proceeding continue, because the trustee derived emoluments therefrom which would terminate if the Chapter X proceeding was not dismissed" (R. 113). During the period in which the trustee holds the title to real estate as a result of a property owner's default, its operations will not be as profitable as they would be if it were holding the mortgage, because, although it may retain a managing agent on a commission basis as set forth in the declaration of trust (R. 30), its duties and responsibilities in managing the real estate are considerably increased. As soon as the property is sold, the fees of the trustee cease altogether. The trustee is simply performing its duty to the state court which appointed it to assert its custody over the *res. In re Heilbroner,* 69 F.

(2d) 643, 644 (C. C. A. 2nd); *Bryan v. Speakman*, 53 F. (2d) 463 (C. C. A. 5th), cert. den., 285 U. S. 539. The reason this cause is in this court is because the trustee, in zealously insisting that the rights of certificate holders be protected to the extent of refusing to approve an extension agreement the terms of which were believed by it to be inadequate, has precipitated a foreclosure which may well result in a complete liquidation and termination of the trust and cessation of its fees. It should also be noted that respondent's trusteeship will not necessarily terminate under a Chapter X proceeding, so that its only motive in opposing this proceeding is a protection of the rights of certificate holders.

There has been a suggestion (Dissenting Opinion, R. 123-124) that state court proceedings have sometimes been resorted to in order to avoid Chapter X proceedings.* That assertion, however, cannot be substantiated in the present situation, where the New York State Legislature, Insurance Department, Mortgage Commission and courts have sucessfully and economically handled the entire certificated mortgage problem for almost nine years (*Report of the Bureau of Trust Supervision, supra* pp. 5-7; *Annual Report of the Mortgage Commission dated April 1, 1939, supra; Reports of Joint Legislative Committee to Investigate The Guaranteed Mortgage Situation, Legislative Documents (1934) Nos. 120 and 121; Report of George W. Alger, Commissioner, to the Governor, supra*, pp. 77-78).

The comments of Mr. (now Mr. Justice) William O. Douglas, in considering the relative desirability of federal

*The only authority for this suggestion cited by the dissenting opinion is a statement made in a note by the editors of the New York University Law Quarterly, XVIII N. Y. U. Law Quarterly Review, 399, 415, 417.

or state control over wage earner bankruptcies, are pertinent. In concluding that essentially local problems should be permitted to be handled by the states themselves, he said:

> "It seems desirable * * * to utilize to the fullest possible extent the administrative procedures and techniques which states have evolved or with which they have gained experience. The alternative of raising a new and huge federal superstructure to handle a function of some familiarity and experience in the states seems unwise." Douglas, Wage Earner Bankruptcies—State vs. Federal Control (1933), 42 Yale L. J. 591, 637-8.

It has been argued by petitioner, the Securities and Exchange Commission and the dissenting opinion that perhaps some good to creditors—that is certificate holders—can result from a petition which has been filed by a debtor with no equity and which apparently is desired by no one other than the debtor. But certificate holders have consented to the state court trusteeship by overwhelming vote. They have selected the trustee in their approval of the Schackno plan. Why should they be made to bear the expense of an attempted fictitious "reorganization" of a debtor which has no interest in the property? Under the state court procedure, as above stated, property owners are required to pay the costs of mortgage extensions, which are small. If there is to be a Chapter X proceeding, the estate, which in reality is the mortgage certificates, must pay the trustee's fees, trustee's counsel fees, debtor's counsel fees, mortgage trustee's fees and fees of its counsel, possibly committee fees and expenses, appraiser's fees, possibly special master's fees, the fees of any persons who assist in working out a plan of reorganization and the other expenses attendant

upon a so-called "reorganization". See Subchapter XIII of Chapter X; 11 U. S. C. 641, 642, 643.

In *In re Frank Realty Co.*, 31 F. Supp. 816 (D. C., M. D. Pa.), the trustee in a Chapter X proceeding disclaimed the debtor's three mortgaged properties because there was no equity in them for the debtor, but the court held that all expenses of the Chapter X proceeding, including appraiser's fees, advertising expenses, special master's fees and trustee's fees and expenses, must be assessed against the mortgagees.

In Schackno trusteeships in the Second Judicial District, the only expense to the trust estates of "reorganizations" consisting of the extension and modification of mortgages has been the costs of the Bureau of Trust Supervision, and the entire cost of operating such Bureau has averaged approximately .011614 of one per cent. per annum of the principal amount of the trusts (*Report of the Bureau of Trust Supervision, supra*, p. 19, footnote p. 9). On the other hand, the expense of federal equity receivership proceedings and of 77B proceedings in the Southern District of New York has been notoriously high, and for the period July 1, 1928 through June 30, 1939 the fees and expenses of administration in bankruptcy proceedings in that district averaged approximately 30% of the assets realized in the bankruptcy estates. 49 Yale Law Journal, p. 9; *House Report No. 3012, 74th Cong. 2d Sess. (1936)*. In the latter report (page 4), it is stated: "Moreover, enactment of the law [H. R. 12064 (An act to amend the Bankruptcy Act of July 1, 1898, to prevent loss of assets and excesive charges in connection with certain reorganizations, compositions, and extensions, * * *)] will eliminate the tremendous and exorbitant costs and fees which have been taken out of the assets in reorganization proceedings under sections 74 and 77B, and there will be no

additional expense to the Federal Government by the designation of the Comptroller of the Currency as Conservator." There is every reason to believe that Chapter X proceedings, because of their further complexity resulting from the additional safeguards they attempt to provide, will prove more costly than have 77B proceedings. *House Hearings on Chapter X*, pp. 367-368 (Sen. Doc. No. 1916, Part 2, 75th Cong., 3d Sess. [1938]6); 52 Harvard Law Review 1349, 1350.

In the one case in which the Circuit Court of Appeals has permitted a Schackno mortgage to be reorganized under Chapter X, *In re Castle Beach Apartments*, 113 F. (2d) 762 (C. C. A. 2nd), the mortgage was in the principal face amount of $441,250, the applications for allowances totalled $35,608.27 and the allowances awarded, exclusive of trustee's administration expenses of $958.37, totalled $11,354.52 (S. D. N. Y. #75836).

The legislative committee appointed to investigate the reorganization of certificated mortgages in New York, in comparing reorganizations effected under the Mortgage Commission and Schackno Acts with those effected under Section 77B with respect to the Prudence Company (which was not an insurance company and whose "bond issues" were not subject to the Mortgage Commission or Schackno Acts), concluded (*New York Legislative Document* [*1938*] *No. 87*, p. 17):

> "Furthermore, in a reorganization under section 77B, the proceedings were complicated and became extended over a long period of time. In such proceedings applications for allowances and fees were made by attorneys for the debtor, numerous certificate holders committees, special masters, trustees, attorneys for trustees, and numerous others, some

of whom had taken insignificant parts in the proceedings. In a number of instances, allowances were made to many of the applicants, creating a burden upon the certificate holders, who eventually were required to pay the cost thereof. *Most of the reorganization proceedings provided merely for the extension of the principal, reductions of the interest rate and the adjustment of arrears.*

In order to remedy the foregoing condition, your committee recommends that the Mortgage Commission Act be amended (Chapter 19 of the Laws of 1935) so that the Mortgage Commission may institute a reorganization proceeding involving a certificated mortgage issue guaranteed by a corporation other than one under the jurisdiction of the Superintendent of Banks or of the Superintendent of Insurance. The latter reorganization proceeding is speedy, expeditious and comparatively inexpensive."

It is interesting to note that in the very recent case of *In the Matter of Jacksonville Gas Company and American Gas & Power Company* (U. S. D. C., S. D. Fla.), decided September 22, 1942, the Securities and Exchange Commission, acting under the Public Utility Holding Company Act of 1935 [15 U. S. C. 79k(e)], promulgated and obtained court approval for enforcement of a plan of reorganization of a utility company providing for the acquisition of title to its property by prior creditors whose interests exhausted the debtor's property, without the expensive and lengthy procedure of Chapter X. In that connection, *The New York Times, September 27, 1942,* Section 3, p. F1, col. 8, reports:

"'There is no reason,' a high source at the SEC said today, 'that I can see why the same formula

could not be made available to any company finding itself in a situation not unlike that of Jacksonville Gas.

"The stresses and strains imposed by the war upon non-war industries most certainly are producing and will continue to produce just such situations. As compared with 77B and Chapter X of the Bankruptcy Act, with their long, costly and involved litigations, we submit that the Jacksonville plan, handled by personnel selected specifically for their task, could achieve better results in less time and with much less expense."

In addition to the expense item, there are other positive disadvantages of a federal court proceeding. In a group issue, such as exists in *In re Paloma Estates,* 126 F. (2d) 72 (C. C. A. 2nd), cert. filed May 12, 1942, No. 89 this term, where there are 102 mortgages and properties held by a trustee for the benefit of 7,500 certificate holders, (each holder having an aliquot interest in each of the 102 mortgages and properties), the reorganization of any one of such mortgages under a Chapter X proceeding means, under the view of the law held by petitioner, that all 7,500 of the certificate holders must be parties to the proceeding and the expense of several printings and mailings alone will be enormous. All of the remainder of the mortgages will still be subject to the jurisdiction of the state court and to the action of the trustee in that court, so that there will be needless duplication and overlapping of effort, together with much confusion.

Moreover, the Schackno trustees have been authorized to and have filed blanket claims against the guaranty companies on behalf of certificate holders and these claims are now being adjusted through the intermediation of the trus-

tees and dividends thereon are being paid to certificate holders through them. *Matter of People (Lawyers Westchester Mortgage and Title Company)*, 288 N. Y. 40. Also, at the present time allocation proceedings are pending in the state courts to fix the costs of the Superintendent of Insurance and of the Mortgage Commission during the periods that they serviced the mortgages and the Schackno trustees are parties to such proceedings. See *In re Pink*, 34 N. Y. Supp. (2d) 758 (Sup. Ct.) (interlocutory order confirming allocation of expenses of Mortgage Commission).

Individual trustees appointed in the federal court will have no familiarity with these matters and probably no power to represent certificate holders with respect to them. This will mean that the Schackno Act trustees will have to continue to function in some matters while the Chandler Act trustees will have to function with respect to other matters. Furthermore, there is the danger that the guaranty of the guaranty companies may be released, at least when the guaranty company is still in rehabilitation, by the consummation of a proceeding under the Chandler Act modifying the rights of certificate holders. The Schackno Act specifically provides that the liability of guaranty corporations with respect to mortgage investments guaranteed by them shall not be discharged by any action taken pursuant to that Act (*Laws of 1933, Chapter 745, Section 7; McKinney's Unconsolidated Laws*, Section 4878). There is no similar provision in Chapter X.

With this background, it is readily understandable why the District Court judges who have sat in the Southern District of New York, and the Circuit Court judges who have sat in the Second Circuit, for the past ten years, have almost uniformly rejected efforts of various minority

groups with doubtful motives to bring the administration of Schackno mortgages into the federal courts. *Jacoby* v. *Bond & Mortgage Guarantee Co.*, 72 F. (2d) 420 (C. C. A. 2nd), cert. den., 293 U. S. 619; *Tolfree* v. *New York Title & Mortgage Co.*, 72 F. (2d) 702 (C. C. A. 2nd), cert. denied, 293 U. S. 619; *Depen* v. *Lawyers' Title & Guaranty Company*, 72 F. (2d) 705 (C. C. A. 2nd), cert. den., 293 U. S. 619; *Brooklyn Trust Co.* v. *Rembaugh*, 110 F. (2d) 838 (C. C. A. 2nd); *In re Blinrig Realty Corporation*, 114 F. (2d) 100 (C. C. A. 2nd); *In re Paloma Estates*, 126 F. (2d) 72 (C. C. A. 2nd). See also *In re Coney Island Hotel Corporation*, 76 F. (2d) 126 (C. C. A. 2nd); *In re Francfair, Inc.*, 13 F. Supp. 513 (D. C., S. D. N. Y.); *In re Reliable Estates*, 33 F. Supp. 588 (D. C., E. D. N. Y.).

From an inspection of the files of the United States District Courts for the Southern and Eastern Districts of New York, it appears that only five guaranteed certificated mortgages subject to the comprehensive state legislation hereinbefore mentioned have been reorganized in the district court and in but one case was this done after the appointment of a Schackno trustee.* This may be contrasted with

*Of eighteen guaranteed certificated mortgage proceedings arising under Section 77B in the Southern and Eastern Districts, where no Schackno trustee had been appointed, eleven were dismissed at the outset, three were retained by the federal courts but later dismissed and remitted to the state courts where permanent trustees were appointed, one was reorganized in the federal court but on expiration of the extension was remitted to the state court where a permanent trustee was appointed, and only three were finally reorganized in the federal courts. Those dismissed at the outset were: *In re Avrum Realty Co.* (S. D. N. Y. #61,228); *In re Bailey Realty Co.* (S. D. N. Y. #61,831); *In re Bedford Realty Co., Inc.* (S. D. N. Y. #60,420); *In re Clarose Holding Corp.* (E. D. N. Y. #27,674); *In re Duce Realty Corp.* (E. D. N. Y. #27,928); *In re Sorola Holding Corp.* (E. D. N. Y.

the fact that well over 13,511 guaranteed certificated mortgages have been reorganized in the State Supreme Court (*supra*, p. 17).

#27,904); *In re 25 East 77th Street Co.* (S. D. N. Y. #60,978); *In re Francfair*, 13 F. Supp. 513 (D. C., S. D. N. Y.); *In re Truesdale Lake Corp.* (S. D. N. Y. #62,215); *In re 24th Street Studio Building Corp.* (S. D. N. Y. #61,556); *In re Walter-arms Realty Co.* (S. D. N. Y. #60,924). The three retained by the federal court and later remitted to the state court were: *In re Church E. Gates & Co.*, 97 F. (2d) 911 (C. C. A. 2nd)—order of dismissal signed June 27, 1939 (S. D. N. Y. #69,680)—order appointing trustee signed June 29, 1939 (Supreme Court, Bronx County, #5,822/1937, *sub nom. Matter of Tiffany Street and East River*); *In re Coney Island Hotel Corp.*, 76 F. (2d) 126 (C. C. A. 2nd)—order of dismissal signed March 26, 1935—order appointing trustee signed December 11, 1935 (Supreme Court, Kings County, #14,668/1933, *sub. nom. Matter of Bond & Mortgage Guarantee Co. (Half Moon Hotel)*; *In re Manbeach Realty Corp.*, 10 F. Supp. 523 (D. C., E. D. N. Y.)—order of dismissal signed April 28, 1936—order appointing trustee and approving extension and modification plan signed March 18, 1936 (Supreme Court, Kings County, #14,668/1933, *sub nom. Matter of Bond & Mortgage Guarantee Co. (2981 Sea Air Avenue)*. The mortgage reorganized and later remitted to the state court was: *Matter of Ashwood Realty Corp.* (S. D. N. Y. #60,455)—order approving plan of reorganization signed August 8, 1935, *In re Ashwood Realty Corp.*, decided February 24, 1939, no opinion (see 37 F. Supp. 670), permitting State Mortgage Commission to modify plan in state court, order relinquishing jurisdiction signed March 21, 1939—order appointing permanent trustee signed by Frankenthaler, *J.*, September 20, 1939 (Supreme Court, New York County, #14,245/1939), *sub nom. Matter of 400 East 58th Street, Manhattan.* The three mortgages reorganized in the federal court were: *In re Island Park Associates*, 77 F. (2d) 334 (C. C. A. 2nd)—order signed confirming plan pursuant to which Title Guarantee and Trust Company purchased all outstanding certificates against the large properties involved and a composition between Title Guarantee and Trust Company and the debtor was approved, *Matter of Island Park Associates, Inc.* (E. D. N. Y. #27,300); *Matter of 455 West 34th Street Corp.* (S. D. N. Y. #61,923); *Matter*

SECOND. The dismissal of the petition was correct because it is unreasonable to expect that a plan of reorganization can be effected.

We realize that mere insolvency in the bankruptcy sense need not necessarily result in a dismissal of a petition at its inception. In some cases it is reasonable to expect that the debtor will raise new money to preserve a good will in the business. *In re Dutch Woodcraft Shops,* 14 F.

---

of Wadsworth Gardens, Inc. (S. D. N. Y. #62,161)—in both the latter cases the order decreed the debtor insolvent and directed sale of the property and appointment of a permanent trustee of the purchase money mortgage.

Seven cases, in addition to the instant case, have arisen after the appointment of a Schackno trustee. In all but one of such cases the petition has been dismissed; in one such case the federal court retained jurisdiction. Those cases dismissed were: *In re Paloma Estates,* 126 F. (2d) 72; *In re Blinrig Realty Corporation,* 114 F. (2d) 100; *Brooklyn Trust Co.* v. *Rembaugh,* 110 F. (2d) 838; *In re Reliable Estates,* 33 F. Supp. 588 (D. C., E. D. N. Y.); *Matter of Chelsea Presbyterian Church* (S. D. N. Y. #73,084); *In re Amawalk Nursery, Inc.* (S. D. N. Y. #60,774). The one case in which the petition was approved was *In re Castle Beach Apartments,* 113 F. (2d) 762, which has already been discussed, *supra* p. 29. In that case, the debtor had purchased the mortgaged property for a very large sum in 1935. The petition asserted an equity of over $50,000 above the mortgage. (Record on appeal, p. 7). The debtor in its brief in the Circuit Court of Appeals argued that insolvency had not been shown, and the Chapter X trustee in his brief stated (p. 8):

> "On the question whether the debtor has any equity, this appellee takes no position, except to point out that this question has not as yet been fully investigated in this proceeding."

Ultimately, the debtor was eliminated from the proceeding because it was found to have no equity and the "reorganization" consisted of the formation by certificate holders of a corporation to take title to the premises (S. D. N. Y. #75,836).

Supp. 467, 471 (D. C., W. D. Mich.); *Case* v. *Los Angeles Lumber Products Co.*, 308 U. S. 106; *Kansas City Ry.* v. *Cent. Union Tr. Co.*, 271 U. S. 445, 455. It is sometimes even reasonable to permit a Chapter X proceeding to continue so that there may be a slow and orderly liquidation. *R. L. Witters Associates* v. *Ebsary Gypsum Co.*, 93 F. (2d) 746 (C. C. A. 5th); *In re Central Funding Corp.*, 75 F. (2d) 256 (C. C. A. 2nd).

But where there is no good will, but simply an apartment house with mortgage indebtedness upon it largely exceeding the value of the premises, there is certainly no reason to require the only interested parties, the certificate holders, to bear the expense of a useless and hopeless Chapter X proceeding. In *Tennessee Publishing Co.* v. *American National Bank*, 299 U. S. 18, 22, this court said:

> "Nor do we need to inquire as to the precise limits of the concept of 'good faith' as required by § 77B. Whatever these limits may be, the statute clearly contemplates the submission of a plan of reorganization which admits of being confirmed as *'fair and equitable'* and as *'feasible.'* However honest in its efforts the debtor may be, and however sincere its motives, the District Court is not bound to clog its docket with visionary or impracticable schemes for resuscitation. Sub-section (f) of § 77B provides for the confirmation of a plan only if the District Judge is satisfied '(1) that it is fair and equitable and does not discriminate unfairly in favor of any class of creditors or stockholders, and is feasible.' These are prime conditions. Unless the District Judge finds that the plan has these qualities he need go no further. Unless he so finds, he has no authority to proceed."

Unless the debtor puts in new money, only a plan of reorganization which gives the entire property to the certificate holders would be considered a fair one. *Reading Hotel Corp.* v. *Protective Committee,* 89 F. (2d) 53 (C. C. A. 3d) cert. den., 302 U. S. 742. Plans of reorganization which permit a debtor, holding a parcel of real estate, its stockholders or junior creditors, to participate under the circumstances existing in this case, have regularly been declared unfair by the courts under Section 77B. *Metropolitan Holding Company* v. *Weadock,* 113 F. (2d) 207 (C. C. A. 6th); *Whitmore Plaza Corp.* v. *Smith,* 113 F. (2d) 210 (C. C. A. 6th); *Sophian* v. *Congress Realty Co.,* 98 F. (2d) 499 (C. C. A. 8th); *Highland Towers Co.* v. *Bondholders' P. Committee,* 115 F. (2d) 58 (C. C. A. 6th).

Here it is obvious that the debtor cannot, will not and does not intend to put up any new money. In paragraph 13 of the petition the debtor swore:

> "13. The purpose of this proceeding is to procure a readjustment of the corporate structure, and all its secured indebtedness, so as to extend the time of payment of said secured indebtedness, upon such terms as will enable the debtor to pay a reasonable amount annually in reduction of the principal thereof in accordance with the provisions of a plan of re-organization to be presented to this Court" (R. 84).

True there are unsupported statements in the papers filed in support of the petition to the effect that new moneys may be made available "if a satisfactory re-organization is consummated" (R. 84, 64), but no indication is given as to who will supply such moneys and it is hard to believe under the circumstances of this case that anyone will do so unless

certificate holders reduce the amount of their mortgage to a point which creates some equity for the debtor (R. 68). Such a plan was disapproved as unfair in *In re Day & Meyer, Murray & Young*, 93 F. (2d) 657 (C. C. A. 2nd), even though the reduction in the first mortgagee's interest was approved by a majority of the first mortgage bondholders.

The courts have in many instances dismissed proceedings under Section 77B and Chapter X either at the outset or during the course of the proceedings, as soon as it became obvious that it was not reasonable to expect that a fair plan could be effected and that no good purpose would be served by permitting the proceedings to continue. *Chapman Bros. Co.* v. *Security-First National Bank*, 111 F. (2d) 86 (C. C. A. 9th), cert. den., 311 U. S. 652, petition under Chapter X dismissed *at the outset* at request of mortgagee where debtor had no equity; *Seaboard Terminals Corp.* v. *Western Maryland Ry. Co.*, 108 F. (2d) 911 (C. C. A. 4th), petition under Chapter X dismissed *before any plan filed* upon showing that debtor had no property to reorganize; *In re Suburban Properties*, 110 F. (2d) 438 (C. C. A. 7th), petition under Chapter X dismissed *at outset* where debtor had no equity and state foreclosure was pending; *In re Corn Kelly Corp.*, 32 F. Supp. 572 (D. C., E. D. N. Y.), aff'd 111 F. (2d) 644, petition under Chapter X dismissed *at outset* where debtor had no equity in real estate being foreclosed in state court; *In re Ware Metal Products*, 42 F. Supp. 538 (D. C., D. Mass.), petition under Chapter X dismissed *at outset* as not in good faith where reorganization was not feasible; *San Francisco Laundry Ass'n* v. *American Trust Company*, 127 F. (2d) 187 (C. C. A. 9th)—petition under Chapter X dismissed *after plan*

filed, where debtor was insolvent and plan was not feasible; *Manati Sugar Co.* v. *Mock,* 75 F. (2d) 284 (C. C. A. 2nd), petition under Section 77B dismissed *at outset* as not feasible and not in good faith; *Price* v. *Spokane Silver & Lead Co.,* 97 F. (2d) 237 (C. C. A. 8th), cert. den., 305 U. S. 626, petition under Section 77B dismissed *after plan filed* where debtor had no equity and prior state court receivership was pending; *Wayne United Gas Co.* v. *Owens-Illinois Glass Co.,* 91 F. (2d) 827 (C. C. A. 4th); petition under Section 77B dismissed *after plan submitted* where debtor had no equity and prior state court mortgage proceeding was pending; *O'Connor* v. *Mills,* 90 F. (2d) 665 (C. C. A. 8th), petition under Section 77B dismissed *after plan filed* where debtor had no equity and federal receivership and foreclosure suit was pending; *Provident Mut. Life Ins. Co.* v. *University Ev. L. Church,* 90 F. (2d) 992 (C. C. A. 9th), petition under Section 77B dismissed *after plan filed,* where plan was visionary and foreclosure proceedings had progressed to sale of the property; *Reighard* v. *Higgins Enterprises,* 90 F. (2d) 569 (C. C. A. 3d), petition under Section 77B dismissed *after plan filed* where plan was not feasible, the debtor had no equity and state foreclosure proceedings were pending; *In re Williamsport Wire Rope Co.,* 10 F. Supp. 481 (D. C., M. D. Pa.), aff'd 78 F. (2d) 1023, petition under 77B dismissed *after plan filed* where plan was impracticable and equity receivership was pending. See also *In re 620 Church Street Bldg. Corp.,* 299 U. S. 24, where this court held that the debtor, its stockholders and junior lienors had no right to appeal after confirmation of a plan of reorganization in 77B proceedings, because they had no equity in the property; *In re Schulte-United,* 50 F. (2d) 243 (D. C., S. D. N. Y.), where a bankruptcy court

allowed mortgagee to foreclose in state court because bankrupt had no equity in the mortgaged property; *Lincoln-Alliance Bank & Trust Co.* v. *Dye*, 115 F. (2d) 234 (C. C. A. 2nd), where mortgagee was permitted to foreclose in state court despite pending Chapter X proceeding because debtor had delayed in formulating a plan; *First National Bank* v. *Conway Road Estates Co.*, 94 F. (2d) 736, 739 (C. C. A. 8th), cert. den., 304 U. S. 578.

It is also unreasonable to expect that a plan of reorganization can be effected, because the mortgage trustee opposes any plan in the Federal court. It is unreasonable to expect that a plan of reorganization can be effected when the granting of a petition is opposed by a creditor such that, even if a plan were to be evolved, attempts to secure approval of the plan would necessarily fail; and the same rule applies when opposition to a petition comes from a preponderant majority of a single class of creditors. *Manati Sugar Co.* v. *Mock*, 75 F. (2d) 284, 285 (C. C. A. 2nd); *In re North Kenmore Building Corp.*, 81 F. (2d) 656 (C. C. A. 7th) (82% of bondholders objected); *In re City Bond and Mortgage Corp.*, CCH Bankruptcy Law Service, ¶ 8118.01; Dec. ¶ 4512; *In re Hotel Park Central, Inc.*, CCH Bankruptcy Law Service, ¶ 8116.03; Dec. ¶ 3545 (92% of bondholders objected); *In re Coronado Hotel Co.*, CCH Bankruptcy Law Service, ¶ 8116.03; Dec. ¶ 3002; *Finletter, The Law of Bankruptcy Reorganization* (1939), p. 60; see Section 216, subd. 7 of Chapter X; 11 U. S. C. 616 (7).

As respects the debtor's petition in the instant case, the respondent Schackno trustee stands in the position of a single first mortgagee or of a unanimous class of first

mortgage bondholders. It, rather than the certificate holders, is the creditor whose assent to any plan is necessary within the meaning of Chapter X. Section 106 subdivision (4) (11 U. S. C. 506(4)) defines a "creditor" as "the holder of any claim". See also Section 197 (11 U. S. C. 597). All claims which certificate holders (as distinguished from Title Guarantee and Trust Company which held legal title to the mortgage, and from Bond and Mortgage Guarantee Company which held reserve powers to enforce the mortgage) formerly held against the debtor were transferred to the Schackno trustee when the Shackno trust was created. *In the Matter of Dalton Schools, Inc.*, D. C., S. D. N. Y. #80,480, *Weil* v. *President and Directors of Manhattan Company*, 275 N. Y. 238; *Matter of People (Tit. & Mtge. Guar. Co.)*, 264 N. Y. 69. See *E. T. C. Corp.* v. *Title Guar. & Trust Co.*, 271 N. Y. 124; *Jacoby* v. *Bond & Mortgage Guarantee Co.*, 72 F. (2d) 420 (C. C. A. 2nd).

Not only does the Schackno trustee have legal title to the bond and mortgage; it also has full and exclusive power to enforce the claims represented by each of those instruments. It was appointed trustee by a valid final order of a court of record of the State of New York through consent of over 66⅔% of certificate holders (R. 42). Pursuant to that order the bond and mortgage were assigned by Title Guarantee and Trust Co. to respondents' predecessor, and the Mortgage Commission, as the holder of any residuum of rights once held by Bond and Mortgage Guarantee Company, joined in the assignment (R. 12). In the same final order, the court directed the execution of a specific declaration of trust (R. 43) which declaration of trust establishes the powers and duties of the trustee

(*Matter of People* [*Lawyers West. Mtg. & Title Co.*], 288 N. Y. 40). By the terms of that declaration of trust the trustee is "vested with all the rights and powers of an absolute owner of the property * * * constituting the Trust Estate and may exercise any and all such rights and powers" (R. 24). The trust estate includes "the bond and mortgage * * * against which were issued the Mortgage Certificates * * * together with all claims and choses in action which Certificate Holders as a class have or may have against any person, firm or corporation with respect to any of the property now or formerly included in the Trust Estate" (R. 23-24). The trustee is specifically empowered "to enforce the claims of the certificate holders as a class against the above named guarantee company and against *any other* person, firm or *corporation*" (R. 25).

In *Matter of People* (*Tit. & Mtge. Guar. Co.*), 264 N. Y. 69, the Supreme Court had approved a reorganization plan directing the depositary of a pool of mortgages* to deliver all the deposited collateral to "Buffalo Series R Corporation", whose certificate of incorporation provided:

> "The corporation shall have all of the right, title, interest and powers of an individual owning said bonds and mortgages and other property and securities in his own name" (Record on Appeal from order of January 8, 1934, fol. 66).

In affirming this order, the court said (pp. 86-87, 92):

> "Ordinarily the holder of certificates of an interest in guaranteed mortgages has no rights or

*Though that case involved a pool of mortgages, the same principles apply to a single mortgage covering a specific piece of property like the one at bar. *Matter of People* (*Westchester Tit. & T. Co.*), 268 N. Y. 432, 439-440.

duties in connection with the mortgage at least as long as the guaranty company is doing business and complies with its own undertakings. The guaranty company under its contract with the holder of the certificate may decide whether to foreclose or extend the mortgage, to waive or to resort to a remedy for any default. * * * when the guaranty company ceases to conduct business, some other person or corporation, must be substituted for it, authorized to administer or, at least, to enforce the mortgage investments in which all the certificate holders are interested.

* * * * * * *

"The essential purpose of the statute is * * * to provide for the adoption of a plan for the permanent administration of the mortgage investments in which groups of investors are interested."

If all rights of ownership in the mortgage herein had been similarly transferred to a corporation, this proceeding could not be entertained over its opposition, on the theory that the stockholders were the real creditors. No different rule should apply in the thousands of reorganizations where these rights of ownership were transferred to trustees instead, pursuant to express statutory authority. In *Montgomery* v. *M'Dermott*, 103 Fed. 801 (C. C. A. 2nd), one McHenry conveyed certain property to trustees as security for a debt. Certificates of participation were issued to McHenry and to the creditor. The court said (pp. 805-806):

"It was an absolute conveyance, and carried the full legal title, with no reservation whatsoever. Thereafter the grantor had no specific individual interest in any specific piece of property so conveyed * * *. His interest in the corpus of the trust was still

> property, but it was not tangible property. It was an equitable interest, which he could enforce only through the aid of a court of equity, constraining the trustees to carry out the trust, and thus get funds in their hands, and, having carried it out, to account for his proportion of the net proceeds of their operations."

The Schackno trustee is not an "indenture trustee" within the meaning of Chapter X and the judge in the Chapter X proceeding is not entitled by Section 212 (11 U. S. C. 612) to "examine and disregard" any provision of the declaration of trust or to "restrain the exercise of any power" under such declaration. An indenture trustee for the purposes of Chapter X is defined by Section 106, subdivision 8 (11 U. S. C. 506 (8)) as "a trustee under a mortgage, deed of trust, or indenture, pursuant to which there are securities outstanding. * * * constituting claims against a debtor or claims secured by a lien upon any of its property". Respondent is not "trustee under a mortgage, deed of trust, or indenture" because the declaration of trust under which it is acting pursuant to the enabling provisions of the New York statutes is not a mortgage, deed of trust or indenture. The declaration of trust has none of the essential attributes of a mortgage or deed of trust. Indentures are defined by the dictionaries as formal written instruments made between two or more persons in different interests. See 2 Bouvier's Law Dictionary; Schumaker and Longsdorf's Cyclopedic Law Dictionary; *Scott* v. *Mills*, 10 New York State Reporter 357, 358. Here the declaration of trust is executed by the Schackno trustee alone, pursuant to court order entered under the provisions of the statute. (R. 36).

Nor is respondent a trustee under an instrument "pursuant to which there are securities outstanding". The certificates, which are the "securities outstanding" in this case, were issued many years ago by Title Guarantee and Trust Company and guaranteed by Bond and Mortgage Guarantee Company. The certificate holders have consented to a "plan of reorganization" under the Schackno Act promulgated by the Mortgage Commission and approved by the court which has resulted in the execution of the declaration of trust under which the trustee is acting. The declaration of trust has been formulated pursuant to the consent of the certificate holders; the certificates are not outstanding *pursuant to* the declaration of trust. Whatever ambiguity might exist in the meaning of the word "outstanding" as used in the statutory definition of an indenture trustee is removed by the "Sectional Analysis of Chapter X" in Senate Report No. 1916 (75th Cong. 3d. Sess; May 27, 1938) at page 23. With reference to Section 106 (8), the Report reads as follows:

> " 'Indenture trustee' (8) is a significant addition to the definition section of the chapter, reflecting as it does the enlarged role which such trustees may play thereunder in representing and safeguarding the interests of securities *issued* pursuant to such indentures."

Section 198 of the Act lends added emphasis to the fact that the term "indenture trustee" meant to the drafters of the Act a trustee designated in a trust instrument pursuant to which securities had been *issued*. Section 198, in so far as it is pertinent, reads:

> "An indenture trustee may file claims for all holders, known or unknown, of securities *issued*

pursuant to the instrument under which he is trustee, who have not filed claims."

If the Schackno trustee were an indenture trustee it would be barred by Section 198 from filing claims on behalf of certificate holders since the certificates are not "securities issued pursuant to the instrument under which [it] is trustee". This cannot be the intention of Chapter X.

Accordingly we submit that the respondent, the Schackno trustee, must be treated as the first mortgage creditor and not as an indenture trustee, and since there is no equity above the first mortgage, no reorganization can be effected without respondent's consent. *Louisville Bank* v. *Radford*, 295 U. S. 555, 585-6, 594-5; *In re Murel Holding Corp.*, 75 F. (2d) 941, 942 (C. C. A. 2nd); *In re Prudence Co.* (*Reconstruction Finance Corporation* v. *Prudence Co., Inc.*), 90 F. (2d) 587, 589 (C. C. A. 2nd). It is as though the Schackno trustee were trustee under a will or *inter vivos* trust, in which event there would seem to be no question but that the trustee rather than the beneficiaries of the trust would vote in a Chapter X proceeding.

Although the Circuit Court for the Second Circuit, in *In re Blinrig Realty Corporation*, 114 F. (2d) 100 and in *In re Castle Beach Apartments*, 113 F. (2d) 762, rejected a similar argument by Schackno trustees in opinions which merely stated the Court's conclusion on the point, two opinions in the Southern District of New York have discussed the point at length and have sustained the Schackno trustee's contention. In *Matter of Amawalk Nursery, Inc.*, S. D. N. Y., #60,774, the District Court held that a Schackno trustee's opposition to 77B proceedings was sufficient reason for dismissal of those proceedings. In *Matter*

of Dalton Schools, Inc., S. D. N. Y., #80,480, decided October 1, 1942, the Special Master filed a report ruling that after the appointment of a Schackno trustee, the trustee alone, to the exclusion of the certificate holders, was entitled to file claims against the debtor in a Chapter X proceeding.

We believe it is particularly important that the paramount right of certificate holders should be considered in this case. The debtor defaulted on its interest and taxes although the earnings of the property were sufficient to cover such items (R. 12, 16) and thus cut off the income of certificate holders who are dependent upon such income. The debtor then permitted foreclosure proceedings to continue for four and a half months before filing a petition under Chapter X. It seems to us obvious that it is the hope of the debtor (which contends that certificate holders must act for themselves rather than through respondent) that it will be able to use the need of the certificate holders to its advantage and to persuade them, in view of the delay and expense which would confront them in a Chapter X proceeding, to accept some plan of reorganization which would give the debtor an equity in the mortgaged property that does not now exist or some chance to gain an income from the property at the expense of certificate holders. Under such circumstances we believe the federal courts are not only justified in dismissing but are required to dismiss the proceedings at the outset rather than to permit them to continue with resultant expense and no possibility of benefit to certificate holders.

Conclusion

The order of the Circuit Court of Appeals should be affirmed.

Respectfully submitted,

CHARLES E. HUGHES, JR.,
CURTISS E. FRANK,
Counsel for Respondent
Manufacturers Trust Company.